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In The

Supreme Court of The United States

No. 48.
October Term, 1936.

TENNESSEE PUBLISHING COMPANY,
PETITIONER,

vs

AMERICAN NATIONAL BANK, C. O. CARPENTER,
RECEIVER, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

REPLY BRIEF ON BEHALF OF PETITIONER TO BRIEF OF AMERICAN NATIONAL BANK, ET AL

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REPLY BRIEF OF PETITIONER TO BRIEF OF APPELLEES

May it please the Honorable Court:

While two questions are discussed in our brief in support of the petition and two questions are discussed in the reply brief, viz: (1) the question of good faith of debtor, and (2) the constitutionality of sub-section (b) (5) of Section 77b, we respectfully submit that the question of good faith was not properly before the Circuit Court of Appeals and that its holding on that question is pure dictum and can have no effect in this Court. That is so because the Trial Judge in the District Court expressly found and held that the plan of reorganization was filed in good faith. (R. 114, 115, 116, 117) The Trial Court closes his opinion of almost three pages of the record by the statement:

> "I refer to these things to emphasize the fact that the petition, in my judgment, is filed in good faith."
>
> (Rec. 116)

The Court in its opinion said on page 116 of the record:

> "So, I find as a fact that the application is not only not in bad faith, but it is in good faith."

Following that statement is a recital of some of the provisions of one of the plans. The Trial Court said:

> "They (the debtor) also proposes, if the lien holders are unwilling to accept new security, for their debts, they will pay in cash, the value of the property covered by the mortgage, the value to be judicially determined by the Court. I have no reason to doubt that they can do just what they say they can do. * * * I certainly would not be justified at this time in finding that they are not financially able to carry out the proposals of the plans."
>
> (Rec. 116)

On October 15, 1935, debtor submitted its amendment to its plan of reorganization with respect to the manner of payment to bondholders and other creditors, which is as follows:

> "(1) The Debtor offers to pay in cash on such reasonable terms and conditions as the Court may fix, the entire amount of the appraised value of the property of the Debtor Corporation or the appraised actual cash value of all valid interests, claims or liens on any of debtor's property when judicially determined. Said payment to be

made into court or under such other arrangement as the Court may hereafter direct.

Or if the Court so direct,

(2) The Debtor offers to pay in cash under the conditions and terms set out in paragraph (1) above, the appraised value of the property as judicially determined by this Court, covered in the recent appraisal of the American Appraisal Company and described therein as "Property covered by the mortgage and/or deed of trust," and to leave for liquidation in any manner deemed suitable by the Court the remaining property of the Tennessee Publishing Company.

(3) This amendment to the plan of reorganization heretofore filed in this cause shall, if the Court so order, supersede and supplant all provisions in any plans of reorganization heretofore submitted by the Debtor, insofar as said plans of reorganization may be in conflict herewith, but no further or otherwise."

(Rec. 86)

It will be noted that the Trial Judge referred to the fact in his opinion that debtor offered to pay cash and said that he had no doubt of the financial ability of debtor to comply with that proposition. There is certainly nothing incomprehensible about this proposition. It will be observed that debtor offered to pay cash for the property of Tennessee Publishing Company as the value of same might be judicially determined by the Court. Second, or in the alternative, to pay in cash the "appraised actual cash value of all valid interests, claims, or liens of any kind on debtor's property when judicially determined." We respectfully submit that this language is plain, clear, and unambiguous. Debtor proposed that the Court should do either one of two things: (1) Appraise all of the property of debtor and debtor would pay cash into Court in the amount so fixed; (2) or that the Court should appraise the value of all valid interests, claims or liens of any of debtor's property (which, of course, would include the bonds) and when the appraised value of the bonds was fixed that debtor would pay that amount in cash into Court. There is certainly nothing indicative of an effort to exploit the corporation nor that the effort to reorganize is made "by visionaries whose illusory and optimistic imaginations outrun their business judgments," (Rec. 157), as suggested by the Circuit Court of Appeals. Neither is there anything indicating that the plan is not feasible or workable, because the payment of cash into

Court and its distribution by the Court to those to whom it is adjudged to be entitled is the simplest sort of proposition and so far as the objecting bondholders are concerned, the plan is already consummated and the question of feasibility or workability does not enter into it. The mortgaged property has been appraised at approximately $295,000.00. If the bonds issued and outstanding are valid, there is something like $900,000.00 due, both principal and interest, thereon. So that the bondholders would receive something over thirty cents on the dollar if the property should be adjudged by the Court to be of its present appraised value.

It is set out by debtor that one block of the bonds of the amount of $60,000.00 was bought at twenty-five cents on the dollar after the receivership bill was filed in this case, and that Mr. Paul M. Davis claims to have bought or optioned $250,000.00 of the bonds, and only claims to have paid, or agreed to pay eighty cents on the dollar, and that he undertook to acquire same long after the receivership case was brought and after different hearings under the petition in this case; also that American National Bank, of which Mr. Davis is president, holds $210,000.00 of these bonds which it took over from Fourth & First National Bank of Nashville under some plan of consolidation of the two banks, and that nothing like the full face value of the bonds was paid therefor, or credits taken therefor, and that not exceeding thirty cents on the dollar of the face value of said bonds was paid by said bank. Also that all the other outstanding bonds were bought at much less than the face value, or only held as collateral to secure indebtedness, and that some of them have changed hands since the debtor was known to be insolvent. (Rec. 97-8)

The inconsistency of the argument of adversary counsel that this plan of reorganization is not feasible or workable because the papers are now losing money in receivership and that they cannot be made to earn a substantial amount, and at the same time pretending that Mr. Paul M. Davis has offered $440,000.00 for the assets of the debtor, is quite noticeable. We shall discuss Mr. Davis's offer further on in this brief.

TWO PROPOSITIONS OF LAW SUBMITTED:

I. THE QUESTION OF GOOD FAITH OF THE DEBTOR WAS NOT BEORE THE UNITED STATES CIRCUIT COURT OF APPEALS. IT HAD NO JURISDICTION TO PASS ON THIS QUESTION.

This case was heard in the appellate court on petition to superintend and revise. (See debtor's petition, Record 139 et seq., and order sustaining same, R. 138.) The petition for leave to appeal was under Section 24B of the Bankruptcy Act. This is the only method by which this case could have been reviewed by the appellate court. It is a "Proceeding in Bankruptcy" which may only be appealed under Section 24B on petition to superintend and revise in matter of law, and is not a "Controversy" arising under Section 24A of the Bankruptcy Act.

The opinion of this Court in **Taylor v. Voss** 271 U. S. 176 is decisive of this question. Under the opinion in that case the appellate court had no authority or jurisdiction to pass upon any question not raised in the petition to superintend and revise. The question of good faith was not raised in that petition, for the reason that the District Judge had decided the question in favor of debtor. (Rec. 124) The only question raised in the petition is that of the constitutionality of Section 77B of the Bankruptcy Act, which is pertinent to a decision of this case.

While our second assignment of error in this Court does not directly call attention to this precise point of want of jurisdiction in the appellate court, we desire now to call the Court's special attention thereto, and, if necessary, to be allowed to amend so as to make that precise point. We respectfully call the Court's attention to the order of the appellate court, which is as follows:

> "On consideration whereof, it is here ordered, adjudged and decreed by this Court that the decree of the said District Court in this cause be and the same is hereby affirmed."
>
> (Rec. 147)

The decree of the District Court shows that the case was heard on the motions to dismiss the debtor's petition and plans of reorganization, and after argument of counsel, and due consideration thereof,

> "The Court is of the opinion that said petition and the plans presented therein and thereby should be dismissed,

except upon the ground that the petition was not filed in good faith, which ground of the motion is overruled, and for the reasons set out in the opinions of the Court which are filed in this cause and ordered to be made a part of the record and a part of this decree," etc.,

it is ordered that the petition of debtor and the various plans of reorganization be dismissed. (Rec. 124)

So that, on the face of the record the appellate court does not modify or change the decree of the District Court. However, in the opinion filed by the appellate court, the question of good faith is considered and it is said that

"The plan fails to meet the statutory test."

(Rec. 157)

The brief filed by adversary counsel seems to overlook the real situation. Debtor filed its petition for reorganization on June 6, 1935. (Rec. 2) An order was entered by the District Court reciting that

"The Judge being satisfied that such petition complies with Section 77B of the Bankruptcy Act, being Title II, section 207, U.S.C.A., and has been filed in good faith, it is ordered, adjudged and decreed, that said petition is hereby approved as properly filed under Section 77B of the Bankruptcy Act. (R. 1).

Thereafter, and on July 13, 1935, debtor filed its first plan of reorganization. (R. 34) Later, on August 31, 1935, debtor filed its supplement to said plan which is called in the record the second plan. (R. 40) On October 14, 1935, debtor filed another petition. (R. 79) On October 15, 1935, it filed an amendment to said last named plan. (R. 86) On October 23, 1935, it filed its third and last plan of reorganization in an effort to meet the views of the District Court. (R. 93) On October 25, 1935, debtor filed an amendment to the last plan of reorganization. (R. 109)

These plans and amendments thereto were considered by the Court upon the motions of American National Bank and others to dismiss the same, which motions appear as follows:

The answer of American National Bank concludes with the following:

"Your respondent therefore moves the Court to dismiss the petition for the reason that it was not filed in

good faith, as shown by the facts and circumstances hereinabove set out."

(Rec. 18-27)

O. H. Ingram and J. C. Bradford, claiming to own $60,000.00 face value of the bonds, answered the petition for reorganization but did not include therein a motion to dismiss. (R. 27)

American National Bank filed its amended and supplemental answer and motion on October 7, 1935. (R. 51) This pleading closes with the following:

"Wherefore, for the reasons shown in this amended and supplemental, as well as those shown in its prior answer, this creditor here and now moves the Court to dismiss said petition as not being filed in good faith for the reasons heretofore shown."

(R. 56)

Messrs. Ingram and Bradford filed another response to subsequent plans, in which no motion to dismiss appears. (R. 98)

Motion of Paul M. Davis (R. 101)

Objections and Motion of American National Bank (Rec. 106)

It will be observed on an inspection of these motions that they are what might be termed "speaking motions." These motions undertake to set up, by way of answer, alleged facts which would make it proper for the Court to dismiss the petition and plans. Since the Trial Court acted on the petition of debtor and the plans of reorganization submitted by it and upon the motions to dismiss same, it was restricted and limited to the facts set out in the petition and in the plans of reorganization. The brief of adversary counsel assumes that the Trial Court as well as the appellate court considered the questions of fact set up in the answers, which could not properly be so considered. A motion to dismiss fills the same office as a demurrer and admits as true the allegations of the affirmative pleading sought to be dismissed. This is elementary.

Furthermore, the position taken by adversary counsel that there is a concurrent finding of the district court and the appellate court that the petition was not filed in good faith is wholly unjustified on this record. There was no such concurrent finding. On the contrary, the District Court in its

order, as heretofore shown, expressly states that the motion to dismiss on the ground of want of good faith is not sustained. (Rec. 124) The order of the District Judge shows that the ground of the lack of good faith is overruled. The first opinion of the District Judge appears in the record at pp. 111-120. It is there said that the motion is sustained and the petition is dismissed under the authority of **Bank v. Radford**, 295 U. S. 555. (R. 120) This oral opinion was delivered on October 15, 1935, after which debtor filed its third plan. Again on October 23, 1935, the Court filed a supplemental memorandum opinion in which he discussed the plan filed on October 23, in which opinion the gist thereof is that the Trial Court considered a sale of its property inevitable, because of the opinion of this Court in the Radford case. The Court concludes the opinion with this language:

> "If two-thirds of the secured creditors should agree to the plan, it would not deprive the minority of a property right for the Court to approve same. But, if none of the secured creditors are willing to accept the plan, and the Court should, notwithstanding, approve it, it would be depriving them of substantive rights in property, and would, therefore, be violative of the Fifth Amendment.
>
> I can see no alternative except to dismiss the petition, and let the property be sold in the equity case."
>
> (R. 123)

This opinion was delivered and filed on October 23, 1935, and the final order and decree was entered on October 25, 1935, following the filing of the written memorandum. (R. 124)

II. SUBDIVISION (B) (5) OF SECTION 77B OF THE BANKRUPTCY ACT IS CONSTITUTIONAL.

ARGUMENT AND AUTHORITIES

The Constitution of the United States, in Article 1, Section 8, Clause (4), provides:

> "The Congress of the United States shall have power, (4) to establish an uniform rule of Naturalization, and

uniform Laws on the subject of Bankruptcies throughout the United States."

Under this provision of the Constitution, it has been held that there was no doubt about the right of Congress to pass a Bankruptcy Act and that when such Act was passed, all State Acts upon the subject of bankruptcy or insolvency wherein discharges were granted to debtors were suspended.

International Shoe Company v. I. Pinkus, et al, 278 U. S. 261.

This Court, in case of **Mueller v. Nugent**, 184 U. S. p. 14, says:

"It is as true of the present law as it was of that of 1867, that the filing of the petition is a caveat to all the world, and in effect an attachment and injunction and on adjudication title to the bankrupt's property became vested in the trustee with actual or constructive possession, and placed in the custody of the bankruptcy court.'

The Bankruptcy Act of 1867, as amended by Act of Congress of 1874, for the first time provided for a composition between the bankrupt and the creditors. That Act, however only related to a composition as between the bankrupt and the unsecured creditors.

The constitutionality of that amendment was attacked on the ground that it violated the Fifth Amendment to the Constitution, but the Act was held constitutional In Re Reiman, Fed. Cases No. 11673, thereafter affirmed in Fed. cases No. 11674. The above decision was referred to with approval by this Court in **Hanover National Bank v. Moyses**, 186 U. S. 187, and likewise cited with approval in **Continental Illinois Bank & Trust Company v. C. R. I. & P. Railroad Company**, 294 U. S. 672.

Thereafter, the Bankruptcy Act of 1898 was passed and the constitutionality of that Act was attacked because it extended to others than traders, provided for exemptions according to the laws of the resident State of the bankrupt and discharge of the bankrupts. It was attacked on the ground that the exemptions were not uniform in the several States throughout the Union, therefore, the Act was unconstitutional as not being uniform. This Court decided in **Hanover National Bank v. Moyses,** 186 U. S., 181, that the Act of 1898 was constitutional.

The Bankruptcy Act of 1898, in Section 12, provides for a composition as between the bankrupt and the creditors. This

section provides that the bankrupt might effect a composition with his unsecured creditors and in event a majority accept the composition proposed, that the same shall be confirmed by the Court, provided the Court determines it to the best interest of the creditors and the bankrupt has not violated other provisions of the Act. This Act was held constitutional and this Court has approved the constitutionality of the holdings of the lower courts on this subject in several cases. Under the Act of 1898, this Court held that a Court of Bankruptcy had the power to order the sale of incumbered property of the bankrupt, free from incumbrances, and, in **Van Huffel v. Harkelrode**, 284 U. S., p. 277, says:

> "The present Bankruptcy Act, (July 1, 1898, 30 Stat. at L.544, chap. 541, U.S. C. title 11, No. 1), unlike the Act of 1867, contains no provision which in terms confers upon bankruptcy courts the power to sell property of the bankrupt free from encumbrances. We think it clear that the power was granted by implication. Like power had long been exercised by federal courts sitting in equity when ordering sales by receivers or on foreclosure. **First National Bank v. Shedd**, 121 U. S. 74, 87, 30 L.ed. 877, 882, 7 S.Ct. 807; **Mellen v. Moline Malleable Iron Works**, 131 U.S. 352, 367, 33 L. ed. 178, 183, 9 S.Ct. 781. The lower federal courts have consistently held that the bankruptcy court possesses the power, stating that it must be implied from the general equity powers of the court and the duty imposed by No. 2 of the Bankruptcy Act to collect, reduce to money and distribute the estates of bankrupts, and to determine controversies with relation thereto."

To the same effect is **Isaacs v. Hobbs Tie & Timber Company**, 282 U.S. 734.

Thereafter, March 3, 1933, the Congress of the United States amended the bankrutcy act of 1898 by adding thereto Section 74 and by such amendment provided that any person, except a corporation, might file a petition or an answer, stating that he is insolvent or unable to meet his debts as they mature, and that he desires to effect a composition or an extension of time to pay his debts.

This amendment provides for the scaling of both secured debts and unsecured debts, or extension of time for payment thereof, by agreement between the bankrupt and creditors; and further provides that a composition might be confirmed after it was accepted in writing, by a majority in number of all creditors whose claims, if unsecured, shall have been al-

lowed, or if secured, or proposed to be affected, by an extension proposal, must represent a majority of amount of such claims.

This section of the Act was held constitutional in the case of **In Re Lindquist**, 70 Fed. (2d) 929, the Court holding that Congress had full power to legislate upon the subject of bankruptcy with respect to all classes of creditors, both secured and unsecured.

On March 3, 1933, Congress also amended the Bankruptcy Act by adding thereto, Section 77, providing for the reorganization of Railroad corporations. That section deals with the readjustment of debts, both secured and unsecured, of railroad corporations and provides for compositions and extensions of indebtedness and the scaling of indebtedness both secured and unsecured. The provisions as to acceptances by the creditors and the confirmation by the Court are very similar to the provisions in Section 12 and Section 74; save and except that in reference to railroad reorganization it must be submitted to the Interstate Commerce Commission for approval, but much wider latitude is given to the Judge in confirming the composition than was given under Section 12 or Section 74, because provisos are in the Act under which the Judge can confirm where the requisite majority do not accept the proposed reorganization, and this same power is in subdivision (b)(5) of 77B.

The constitutionality of Section 77 was before this Court in the case of **Continental Illinois Bank & Trust Company v. C. R. I. & P. Railroad**, 294 U.S., 678, and this Court in an exhaustive opinion held such Act constitutional.

On June 7, 1934, by Act of Congress, the Bankruptcy Act was further amended by the addition of Section 77A and Section 77B. Up to the time of the passage of this amendment there was no provision whatsoever for the reorganization of a corporation, or the extension of its indebtedness, other than railroad corporations, hence Congress, in its wisdom, realizing the economic situation, passed this Act by adding Sections 77A and 77B to the Bankruptcy Act. The purpose of this amendment is stated in Section 77A as follows:

> "In addition to the jurisdiction exercised in voluntary and involuntary proceedings, to adjudge persons bankrupt, Courts of bankruptcy shall exercise original jurisdiction in proceedings for relief to debtors as provided in Section 77B of this Act."

Section 77B provides:

"(a) That any corporation which could become bankrupt under Section 4 of the Act and any railroad corporation or other transportation corporation except a railroad corporation, authorized to file a petition under Section 77, may file an original petition or answer for corporate reorganization under this section."

The Circuit Courts of Appeals have passed upon the constitutionality of Section 77B in the following cases.

Campbell v. Allegheney Corporation, 75 Fed. (2d) 947, (certiorari denied, 59 Sup. Ct. 104), in which the Court said:

"77B was passed for the purpose of giving an opportunity to an embarrassed corporation made necessary by economic depression and its purpose should be forwarded by a fair and liberal construction, and not thwarted by a narrow or technical interpretation.

Section 77B of the Bankruptcy Act requiring secured creditors of a corporation to scale their debts in accordance with a plan which two-thirds of them are willing to accept and which has been approved by the Court as reasonable and fair, and accept in lieu of money such securities as are specified in the plan, is not such an arbitrary and unreasonable exercise of the bankruptcy power as to amount to a denial of due process.

The fact that secured debts are affected by the corporate reorganization amendment to the Bankruptcy Act (77B) does not affect its constitutionality.

Like other constitutional grants of power, that giving Congress power over bankruptcies is to be interpreted not in the light of the conditions with which the framers of the Constitution were familiar, but of what is required under modern conditions to deal adequately with the relationship existing between embarrassed debtors and their creditors."

The Section was also held constitutional **In re Central Funding Corporation**, 75 Fed. (2d) 256, in which the Court, at p. 261, says:

"Section 77B and the plan proposed under it do not

violate the Fifth Amendment, either with respect to due process or otherwise.

In **Gilfillan Union Canal Co.,** 109 U.S. 401, 3 Sp. Ct. 304, 27 L.ed. 977, a special act of the state of Pennsylvania, whereby a plan to refund a corporate indebtedness through an issue of new securities was to be binding on bondholders who did not file their dissents within three months, was held not to impair the obligation of contracts. Similarly in **Canadian Southern R. Co., v. Gebhard,** 109 U. S. 527, 3 S. Ct. 363, 27 L.ed. 1020, a Canadian statute provided for a reorganization upon the consent of two-thirds of the stock and three-quarters of two classes of bonds by an exchange of bonds secured by a new mortgage for former securities. The Supreme Court said, at p. 536 of 109 U.S. 3 S. Ct. 363, 369: 'In no just sense do such governmental regulations deprive a person of his property without due process of law.' The New York Court of Appeals, in sustaining a reorganization under the Schackno Act (Laws 1933, c. 745, as amended), reached a similar conclusion. Matter of People by Van Schaick v. Title & Mortgage Guarantee Co., 264 N.Y. 79, 190 N.E. 153. Our decision in Matter of Allied Owners Corporation, Debtor, 74 F. (2d) 201, on December 10, 1934, and in Re Prudence Bonds Corp. (Ex parte Radin), 75 F. (2d) 262, handed down herewith, each dealt with section 77B and are also to the same effect. The proposed plan provides a fair equivalent for any rights the bondholders have lost. Such a deprivation is not more than what is in substance involved in any bankruptcy administration and in no way transcends the Fifth Amendment."

The same Section was also held constitutional by the Circuit Court of Appeals in **Re New Rochelle Coal & Lumber Company**, 77 Fed. (2d) 881, and in that case the Court said:

"Section 77B does not require a guarantee of the payment of debts or bonds of the corporation."

In that case an extension and readjustment was proposed and confirmed.

In none of the above cases was the constitutionality of subdivision (b)(5) expressly raised or passed upon, but in the case of **Campbell v. Alleghaney Corp.**, 75 Fed. (2d) 954, the Court said:

"The act is based upon an equitable recognition of the

rights of all who have an interest in a common property, and is in accord with the principle under which courts of equity have denied to dissenting creditors the right to prevent the consummation of a plan of reorganization which has been found to be fair and open to all creditors on the same terms. See **Fearon v. Bankers Trust Co.** (C.C.A. 3d) 238 F. 83; **Simon v. New Orleans R. Co.** (C.C.A. 5th) 242 F. 62. It embodies substantially the same principles of corporate reorganization adopted in England and Caanda many years ago, and, as shown above, held reasonable by the Supreme Court in the case of **Canadian Southern Ry. Co. v. Gebhard**, 109 U. S. 527.

The Circuit Court of Appeals, in the case of **Downtown Investment Association v. Boston Metropolitan Buildings**, 81 Fed. (2d) 322, says:

"Appellant further contends that the debtor's plan is not a proper plan in that it (1) extends the maturity of the bonds for eight years; (2) it requires them to release all unpaid interest to July 1, 19.... (3) gives them after July 1, 1934, fixed interest of only 3 percent and an additional 1 percent if earned, and after the payment of 1 percent to the holders of the second mortgage bonds a final 1 percent if earned; (4) the sinking fund requirements of the present mortgage are to be waived temporarily; (5) the mortgage is to be subordinated to a proposed lease.

Authorization for these so-called objectionable features of the plan may be found in 77B, cl.(b), which provides that a plan of reorganization may include provisions modifying or altering the rights of creditors generally or of any class of them secured or unsecured, either through the issuance of new securities of any character or otherwise; may include provisions modifying or altering the rights of stockholders or any class of them; and shall provide adequate means for the execution of the plan which may include the transfer of all or any part of the property of the debtor to another corporation; may provide for the retention of the property by the debtor the distribution of assets among creditors of any class thereof; the satisfaction or modification of liens, indentures, or other similar instruments; the curing or waiver of defaults; the extension of maturity dates of outstanding securities; the change in interest rates and other terms of such securities; the issuance of securities of either the debtor or any such corporation or corporations for cash, or in exchange for existing securities or in sat-

isfaction of claims or rights or for other appropriate purposes and may include any other appropriate provisions not inconsistent with the Act.

It thus appears that all these features of the plan objectionable to the first mortgage bondholders appear to be authorized by the statute."

It will be thus seen that while the Circuit Courts of Appeals have not singled out subdivision (b) (5) as to its provisions, yet, nevertheless, those Courts have held 77B constitutional and the language used in their decisions can lead to no other conclusion than that in their opinion, subdivision (b)(5) is within the power of Congress when legislating upon the subject of bankruptcy.

The power given in (b) (5) is a power exercised for many years by equity courts in reference to receivership proceedings and reorganization proceedings of railroad corporations. In case of **Phipps v. C. R. I. & P. Ry. Co.**, 284 Fed. 945, the Court held:

"Where a decree approving reorganization of an insolvent railroad company secured or offered to unsecured creditors their just and equitable shares of the beneficial interests in the reorganized corporation, the court may lawfully enjoin enforcement of claims of such creditors by execution against the property, or otherwise than as provided in the decree.

It is not essential to the valid reorganization of an insolvent railroad company, in accordance with a plan approved by a large majority of its general creditors and also of its stockholders that its property should be transferred to the reorganized corporation through the medium of a judicial sale."

In case of **Palmer v. Bankers Trust Company**, 12 Fed. (2d) 747, in which case the Denver and Rio Grande Railroad Company had a reorganization, it was provided that the property be sold to a new company and that it should issue general mortgage bonds, secured by a mortgage on the property of the new company, and also preferred stock, and that the exchange should be on the basis of Seven Hundred and twenty-five ($725.00) Dollars, general mortgage bonds, and Four Hundred ($400.00) Dollars par value, preferred stock for each one Thousand ($1000.00) Dollars refunded or adjustment

bonds taken up. The plan was approved by a large majority of the bondholders.

It was opposed by Palmer, who endeavored to get a foreclosure on his bonds or a payment therefor. The Court, in passing upon his contention, at p. 754, said:

> "While a court of equity will not allow minority bondholders to be disregarded or unfairly treated in a reorganization plan, yet on the other hand, it will not lend its aid to a scheme by a minority bondholder of holding up a fair reorganization plan, solely as a means for obtaining greater value or more favorable terms for his bonds than are to be given by the plan to the great majority of the bondholders. **Especially is this true if it should appear that the minority bondholder has bought his bonds pending the reorganization and for the purpose of speculating thereon.**"

This court, in case of **Louisville Joint Stock Land Bank v. Radford**, 295 U. S. 555, when considering the constitutionality of the Frazier-Lemke amendment to Section 75 of the Bankruptcy Act by adding subsection S to Section 75, which subsection this court held unconstitutional, at pp. 585-586, said:

> "So far as concerns dissenting creditors, the composition is a method of adjusting among creditors rights in property in which all are interested. In ordering the adjustment, the bankruptcy court exercises a power similar to that long exercised by courts of law. **Head v. Amoskeag Mfg. Co.**, 113 U. S. 9, 21, 28 L.ed. 889, 893, 5 S. Ct. 441, and of admiralty. The **Orleans v. Phoebus**, 11 Pet. 175, 183, 9 L. ed. 667, 680. It is the same power which a court of equity exercises when it compels dissenting creditors, in effect, to submit to a plan of reorganization approved by it as beneficial and assented to by the requisite majority of creditors. **Shaw v. Little Rock & Ft. S. R. Co.**, 100 U.S. 605, 25 L.ed. 757; **Kansas City Terminal R. Co. v. Central Union Trust Co.**, 271 U.S. 445, 70 L. ed 1028, 46 S. Ct. 549; (Compare **National Surety Co. v. Coriall**, 289 U.S. 426, 77 L.ed. 1300, 53 S. Ct. 678, 88 A.L.R. 1231). **First National Bank v. Flershem**, 290 U.S. 504, 78 L.ed. 465, 54 S. Ct. 298, 90 A.L.R. 391. In no case of composition is a secured claim affected except when the holder is a member of a class; and then only when the composition is desired by the requisite majority and is approved by the court."

The reason that the Court held subsection (s) of Section

75 of the Bankruptcy Act unconstitutional was that the Section was not at all comparable to a composition, and the Court said:

> "Never, so far as appears, has any composition affected a secured claim held by a single creditor. Compositions are comparable to the voluntary adjustment with the Mortgagee provided for in section 3 of the Frazier-Lemke Amendment. They are not analogous to the so-called adjustment compelled by Section 7."

The Court, however, in **Louisville Joint Stock Land Bank v. Radford**, specifically held that the Frezier-Lemke Act was not a Bankruptcy Act and did not comply or comport with the provisions relative to bankruptcy, hence, that where Congress legisalted, even though it named the subject bankruptcy, if it was not in truth and fact a bankruptcy act, and violated other sections of the Constitution, the power to legislate upon the subject of bankruptcy did not give Congress the power to violate the Fifth Amendment to the Constitution, or any other section of the Constitution, but the Radford case distinctly upholds the right of Congress to legislate upon the subject of bankruptcy and provide for the scaling of debts thereby.

The purpose of writing subdivision (b)(5) into the law, as well as subdivision (b)(4), was to give the Courts in Bankruptcy proceeding a power that had not heretofore existed in a Court of Bankruptcy. If (b)(5) be unconstitutional, then Section 77 as to its corresponding subdivisions is unconstitutional.

Courts of equity had, in reorganization proceedings, forced by judicial decree the will of the majority upon the minority, where to do so was doing equity as between the persons of the same right and the same class. That power had long been exercised and the cases are cited in Judge Brandeis' opinion in the Radford case, upholding this power and the length of time for which it has been exercised. Consequently, when Congress was passing an act for the relief of debtors and for the purpose of rehabilitating rather than liquidating, it intended to give to Courts of Bankruptcy, first, all powers that a court of equity could exercise in a receivership proceeding, and it specifically so wrote it in the Act, and in order that recalcitrant creditors could not deprive a Court of its power, and when a plan which a debtor and its creditors had worked out for mutual advantage, and the best interest of all, was before the Court, that the Court could confirm that plan and

prevent a recalcitrant or scheming creditor from preventing the approval and confirmation of such plan. Hence, it was expressly provided that the Court had power to approve and confirm a plan, even though two-thirds of the creditors of each class had not accepted, and prevent some creditors from blocking the plan, or from seeking to obtain greater value or more favorable terms for their bonds or debts than is proposed by the plan to be given to the bondholders or creditors of each class.

It is true that subdivision (b)(5) provides for adequate protection for the realization of the value of the interest, claims or liens of each class of such non-consenting creditors exceeding one-third.

We cannot help but believe that Judge Simon has misapprehended what this Court held in case of **Louisville Joint Stock Land Bank v. Radford**, because if Section 12 of the Act is constitutional, and Section 74 of the Act is constitutional, and Section 77 of the Act is constitutional, and a composition or reorganization can be effected where a majority of each of the classes accept the composition or reorganization, then if the will of a majority can be enforced on the one third, or minority, of non-consenting creditors, that is as much a deprivation of property of the one-third as it would be if the **Court** was authorized to confirm a plan where less than two-thirds of each class accpeted. **In other words, whether one man of a class has his claim scaled or one hundred have their claims scaled, there can be no fine spun distinction between the deprivation of property as to the one or the one hundred.**

Judge Simon failed to consider the distinction between (b) (5) of 77B and sub-section (s) of 75; (b) (5) relates to classes and provides for equality; (s) of Section 75 relates to only one class—mortgagees; and did not provide for equity or equality, so far as the rights of debtor and mortgagee are concerned.

We are not unmindful of the decision of Judge Hand **In Re Murel Holding Corporation,** 75 Fed. (2d), 941, in which, as to Section 77B, subdivision (b) (5) (d), he says:

> "The last is not, properly speaking, a method at all; it merely gives power generally to the Judge, equitably and fairly to provide such protection, that is adequate protection, when other methods are not chosen * * * * * * It is plain that adequate protection must be complete compen-

sation and the payment ten years hence is not, generally speaking, the payment now."

In the case before Judge Hand, his decision was unquestionably correct on the facts and we fully agree that subdivision (b) (5) (d) is not a method, but it is certainly a power and jurisdiction given to a Judge in a bankruptcy proceeding and it was evidently given for a purpose, so that the Court could have all the powers formerly exercised by courts of equity in reorganization proceedings in reference to dealing with recalcitrant creditors or scheming minorities, or individuals.

We concede the adequate protection for the realization of the value of the interest, claims, or liens of the creditors of each class must be completely compensatory, but what is completely compensatory under (b) (5) (d) is to be determined by the Court, and his opinion is the determining factor under the law. His opinion is, of course, subject to review and in event it be held he erred in that regard the case may be reversed, but that does not make that subdivision of the Act unconstitutional.

In the next to the last paragraph of the subdivision (b), Congress provided:

> 'That the Judge shall scrutinize and may disregard any limitations or provisions of any depository agreements, trust indentures, committee **or other authorizations affecting any creditor acting under this section and may enforce an accounting thereunder or restrain the exercise of any power which he finds to be unfair or not consistent with public policy** and may limit any claims filed by such committee member or agent, to the actual consideration paid therefor."

Hence, it will be seen that the power given the Judge by the language "or restrain the exercise of any power which he finds to be unfair or not consistent with public policy," certainly meant something. It evidently was intended to let the Judge determine whether a plan provided adequate protection for the realization of the value of the interest, claim or liens of creditors, and in event he did so, the power was given to confirm a plan.

In other words, the opinion of the Court that a plan is fair, feasible and equitable, that it provides adequate protection for the non-consenting creditor of each class is conclusive and the Court has the power to say this plan is in the interest of

all; your security is adequately protected; you have the same right of security and realization that other creditors of the same class are given under this plans. and you are deprived of nothing in the rehabilitation of this corporation.

Subdivision (b), clause (5) (d): "By such method as will in the opinion of the Judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection," was certainly intended to have some meaning and give some power to the Judge to control the action or scheming, grasping or recalcitrant creditors.

We admit (b) (5) (d) is not a plan, but it certainly gives the Judge power to act. In other words, it gives the Court the power in a reorganization to prevent extortion or prevent a sacrifice of debtor's property by foreclosure because one lien creditor or a group of lien creditors desire foreclosure so they may acquire that property under forced sale and prevent a debtor from paying its creditors their just debts and at the same time save the equity, if any, in its property for its stockholders, as was held by Judge Boynton in Waco Development Company case.

A full discussion on this subject will be found in Bankruptcy Reorganizations under 77B, by Judge Johnson, Section 603, pp. 517-519.

In **Re: Island Park Associates,** 77 Fed. (2d), 334, the Court says:

> "The purpose of the Act is to avoid immediate liquidation of the property involved in the reorganization of a corporation and its subsidiaries with a view to rehabilitate rather than liquidate."

In **Re Allied Owners Corporation,** 74 Fed. (2d), 1. c. 204, the Court says:

> "Section 77B is concerned with corporate reorganization. Its principal purpose was to provide relief against recalcitrant minority creditors or debtors unable to reach all creditors."

In **Campbell v. Allegheny Corporation,** 75 Fed. (2d) 974, (Certorari denied, 59 Sup. Ct. 104) the Court says:

> "77B was passed for the purpose of giving an opportunity to an embarrassed corporation made necessary by

economic depression and its purpose should be forwarded by a fair and liberal construction, and not thwarted by a narrow or technical interpretation, and certainly by not reading into its language conditions and limitations which the lawmakers did not see fit to express."

In **Re Consolidated Coal Co.,** 11 Fed. Supp. 594, the Court said:

"There being no similarity between Section 77B and Section 75 (s), the decision of the Supreme Court holding the latter unconstitutional does not indicate that Section 77B is also invalid."

Bankruptcy Acts must provide equality as between creditors of each class, and when so drafted, then Congress has only exercised the power given it under the Constitution and an Act so drafted forcing an objecting creditor to accept the same treatment accorded creditors of the same class who accept, or to accept just compensation for their claims or liens, does not violate the Fifth Amendment, or any other provision of the Constitution.

THE PAUL DAVIS BID

While we think the reference to the bid of Mr. Paul Davis of $400,000.00 for the property covered by the trust deed and $40,000.00 for the other property belonging to debtor si wholly immaterial, nevertheless we desire to call the attention of the Court to the attiude of Mr. Davis in this case. Reference to his bid appears on page 13 of the brief of adversary counsel. It is there stated that Mr. Davis offered to purchase the properties covered by the bond mortgage "and to pay the sum of $400,000.00 therefor and to pay an additional sum of $40,000.00 for the assets not covered by the bond mortgage."

As stated in that brief this statement is very misleading. His offer appears in the record at page 100A. An examination of that offer shows that it is made upon the following conditions, to-wit:

1. "Said offer is made especially subject to all of the terms, conditions and provisions contained in the above mentioned deed of trust from Tennessee Publishing Company to the trustees;"

2. It is made subject to the right to make settlement by applying towards the payment of the purchase price, and to be

credited thereon, any outstanding bonds and maturing and unpaid interest coupons to the amounts to which such bonds and interest coupons would be entitled upon a distribution among the holders of the bonds of the net proceeds of such sales after making the proper deductions for the costs and expenses of the sale.

3. Said offer is made conditionally as follows: That "In the event the court shall order all the properties and assets of Tennessee Publishing Company sold in this cause under the terms and subject to the provisions of the aforementioned deed of trust, such order to be entered herein within thirty days from the date of filing of this offer," etc.

4. Upon the condition that the report of Byrd Douglas, standing master, filed on March 20, 1935, be confirmed by the Court "with respect to the lien of said deed of trust and the properties and assets covered thereby." In other words, that the Court adjudge these outstanding bonds to be valid and legal to the extent of the full amount.

On September 13, 1935, debtor filed its petition to stay further proceedings until it should be determined in the receivership case whether or not said bonds are valid. In paragraph III of said petition it is alleged,

> "Petitioner would further show to the Court that recently a petition has been filed in the case of C. O. Carpenter, receiver, v. Tennessee Publishing Company by certain unsecured creditors of petitioner, in which petition said unsecured creditors are raising very serious questions as to the validity of certain bonds or secured claims which have been filed and undertaken to be proven in said receivership case, and are included in the report filed by the master therein." (R. 49.)

Nowhere in this record is that allegation denied, said report of the standing master in the receivership case has never been confirmed, and said cause now stands on the report and on the petition of unsecured creditors challenging the validity of debtor's bonds, and the alleged offer of Mr. Davis is conditioned upon the dismissal of said petition and the affirmance of the report of the special master.

It is also worthy of special mention that in the answer filed by American National Bank the ownership of the outstanding bonds is stated, among which is Canal Bank & Trust Company, $250,000.00 (R. 19). Mr. Davis filed his intervening pe-

tition in the case in the nature of an offer, on October 25, 1935, in which he says:

> "Petitioner has recently acquired the debtor's bonds, formerly held and owned by Canal Bank & Trust Company, in the principal sum of $250,000.00, being Bonds Number 1 to 250, inclusive, with interest coupons thereon at six and one-half per cent from November 1, 1932."

In other words, this record shows that long after the petition for reorganization was filed by debtor on June 6, 1935, Mr. Davis made some kind of deal (not disclosed on the record) with Reconstruction Finance Corporation, and then came into this Court and sought to block the reorganization plans of debtor.

We insist the same rule should apply to a purchaser under such circumstances "buying in" for purpose of blocking reorganization plan as would apply to an outsider undertaking to buy into an insolvent corporation for the purpose of presenting a reorganization plan. This paper was a Carmack paper from its inception. There has never been a time since 1908 that the Carmack family did not own a substantial interest in the company. E. W. Carmack, Jr., is not an interloper nor an intermeddler. Mr. Davis is a banker and therefore is buying into this situation to make money out of it; Carmack is a successful newspaper man and bought Colonel Lea's stock in order that he might operate the paper, which he says in his petition or one of his plans for reorganization that he can operate at a profit. The exact statement in the petition is as follows:

> "Debtor has made considerable investigation of the present operating expenses of its affairs, and also of its business, and is thoroughly convinced that large savings can be had in carrying on and operating its business, and in no way affect or lower the efficiency; and that it can and will carry on its affairs and publish the papers which are now being published, at a very material reduction in cost, and in such a manner as to return good profits, and make of it a gainful and profitable business."
>
> (Rec. 96)

On the motion to dismiss, this allegation must be taken as true. It was the purpose of Mr. Carmack to save something for his widowed mother and himself out of their hold-

ings left by his father, and not to speculate upon the misfortunes of the corporation.

When the receivership bill was filed the interest on the bonds was not in default (R. 109). It is further shown that the receiver had an abundance of funds in his hands during the operation of the receivership to pay all of the accrued interest on the bonds if any was due, but that he had not used the money for that purpose, but for other purposes; that he spent $45,000.00 of the receipts of operation in extending the circulation and building up extravagant agencies, establishing motor deliveries, etc., which did not add materially to the value of debtor's properties; that the receivership had added very materially to the cost of operation of the business by unnecessarily increasing salaries alone approximately $90,000.00 a year as shown by the report of the appraiser; that the receiver had paid out of debtor's business about $60,000.00 on an unsecured claim of a creditor whose debt was in existence and due from debtor, if due at all, prior to the appointment of the receiver, and that it is believed that this money was paid out unlawfully, and was paid to certain objecting bondholders, but not on their bonds, but on this preexisting debt and upon the advice of one of the attorneys for the receiver in this case. This attorney also represents the bank and represents Mr. Davis. These charges are nowhere denied on this record.

Under this very unusual set of circumstances, and in view of the objection of M. & O. Paper Company, an unsecured creditor (R. 100) the Trial Judge said that it was hard to understand why that creditor would choose nothing rather than preferred stock and that the action of these objectors **"savors of a collusion which doesn't look good."** (R. 117)

The pleadings filed in this cause by petitioner which are taken as true on this hearing on the motion to dismiss, show that there has been great waste of the assets of the corporation and that this is a valuable property in the hands of an experienced newspaper man, and that this is a contest between the corporation owned in whole or in part for years by the Carmack family, and by certain banks or bankers who have come into this case under the circumstances above set forth.

Wherefore, petitioner most earnestly insists that as a going concern in the hands of the family that has built it and made it valuable, it is worth far more to its stockholders and cred-

itors than in the hands of speculators or banks. Therefore, we respectfully ask that this case be reversed to the end that this corporation may be saved.

Respectfully submitted,

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